

Internal Revenue Service
memorandum

CC:TL-N-6961-91
Br4:JTChalhoub

date: **MAY 28 1991**

to: District Counsel, Newark MA:NEW
Attn: William S. Garofalo

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [REDACTED]
NOL and Credit Carrybacks

This is in response to your request, dated May 7, 1991, for tax litigation advice involving the subject case.

ISSUE

May tentative allowances granted under I.R.C. § 6411 be recaptured following audit of the source years, if a previous settlement of the Tax Court suit involving the carryback years stipulates out the carryback issue erroneously raised in the pleadings of the Tax Court suit.

CONCLUSION

We agree with you that res judicata would bar the Commissioner from recapturing an excessive tentative allowance after a Tax Court decision became final in which the pleadings (correctly or incorrectly) placed in issue a net operating loss deduction or credit carryback.

FACTS

Your request for advice indicates that [REDACTED] is before the Tax Court for the tax years [REDACTED], [REDACTED] and [REDACTED]. Although your request for advice states the "deficiencies in the statutory notice were computed as if no carrybacks were allowable," you have (by telephone) advised that statement to be incorrect. The deficiencies for [REDACTED] thru [REDACTED] were computed based upon the tax liability reported on the original returns as if the tentative allowances had not been made. Accordingly, the notice of deficiency does not raise any issue with respect to the carrybacks.

The taxpayer, whether inadvertently or deliberately, raised the propriety of the carryback allowances as errors in computing the deficiency. From our conversation, we were advised the Commissioner's answer denied the allegations and issue has been joined, notwithstanding the fact the Service has not determined whether such carrybacks are allowable and will not make a final determination until completion of the audit for the source years of the carryback allowances.

009488

The parties to the Tax Court case have been discussing settlement and taxpayer's counsel [REDACTED], by letter dated [REDACTED], proposes that the carryback issues be stipulated out of the settlement with the understanding the taxpayer will stipulate that summary assessments under I.R.C. § 6213(b)(3) may be made after settlement of the Tax Court case. [REDACTED], as you are aware, is under the mistaken impression that the carrybacks to [REDACTED] were disallowed in the notice of deficiency. On pp. [REDACTED] and [REDACTED] of her letter she recognizes the prohibition on lifting the bar of res judicata by a taxpayer's claim for refund if the issue was raised in the prior Tax Court proceeding.

DISCUSSION

The position of the Service expressed in Rev. Rul. 88-88, 1988-2 C.B. 354, that summary assessment will be made to recapture an excessive tentative allowance where the issue was not raised in the Tax Court pleadings, is a practical solution for several reasons. First, the Commissioner in a suit for erroneous refund has a two-year statute of limitations to recover an excessive allowance. Most often, that statute of limitations will have expired. Secondly, as in the case of claiming an increased deficiency in the Tax Court suit, the Commissioner would be disadvantaged by having to assume a burden of proof if he sued to recover an erroneous refund. Thus, the practical solution is to make a summary assessment. A summary assessment is practical even where the carryback issue was not raised in the notice of deficiency, or in the Tax Court pleadings. The position of the Service, until litigation suggests otherwise, is that recapture by summary assessment is available "at any time" so long as the statute of limitations for the loss year or source year of the carryback is open under I.R.C. §§ 6501(h) or (j) and even when the decision of the Tax Court is final. There is a school of thought to the contrary by certain members of the private tax bar that the Commissioner is not protected under I.R.C. §§ 6501(h) or (j) and that res judicata applies if he allows the Tax Court decision to become final without claiming an increased deficiency. Where the carryback year is open in the Tax Court case and the source year has expired, arguably, the Commissioner may summarily assess an excessive tentative allowance because he could still claim an increased deficiency for that year. See *Calumet Industries, Inc. v. Commissioner*, 95 T.C. 257 (1990).

The facts in the instant case indicate that both the Service and [REDACTED] would be prejudiced by the bar of res judicata if the issue were stipulated out of the case, because the issue was raised (erroneously it seems) in the pleadings. Although you have suggested moving to strike allegations in the pleadings with respect to any carryback issue, we recommend against that course of action on the present state of the record. Instead, we recommend acceleration of the audit for the loss year (or years) and a summary assessment of any excessive allowance once a determination has been made. This means leaving [REDACTED] open until completion of the examination involving the carryback. If the taxpayer declines to extend beyond [REDACTED], the statute of limitation on assessment for the source years, [REDACTED] and [REDACTED], without a total settlement of the Tax Court case, we recommend you document that fact by exchange of correspondence with the

taxpayer to justify summary assessments of the total of the tentative allowances without audit. (If upon later litigation, or audit, the taxpayer is entitled thereto we arguably should not be liable for litigation costs.)

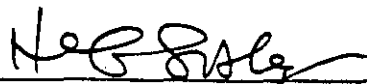
If summary assessments are made, and the taxpayer pays the summary assessments, the taxpayer should be allowed to amend the petition to claim an overpayment. Summary assessments alone, without payment, may not give the Tax Court jurisdiction to decide the carryback issue where the notice of deficiency did not include disallowance of the carryback. Only where an I.R.C. § 6213(b)(3) assessment has been paid is the taxpayer permitted to raise the issue by alleging an overpayment in an amended petition. If the taxpayer fails to make payment, it would then be appropriate to move to strike allegations relating to the carrybacks.

By memorandum, dated December 13, 1983, copy attached, we asked the Interpretative Division to consider that a tentative allowance not be a "rebate" within the meaning of I.R.C. § 6211(b)(2). Our purpose was to distinguish a tentative allowance from other refunds so that unaudited carrybacks could be ignored in determining deficiencies for the carryback year. In O.M. 19801, dated April 13, 1984, copy attached, the Interpretative Division declined our proposal and suggested "a notice of deficiency should not be sent *** until an examination of the loss year is performed." The reasoning of O.M. 19801 applies with equal force today.

Also, attached for your information is a copy of our formal tax litigation advice, dated October 21, 1981, to the District Counsel, Hartford, where a problem similar to the one you raise was discussed. If all issues for [REDACTED] through [REDACTED] in the [REDACTED] case have been settled, except for the carryback loss (or credits), it would be appropriate for the taxpayer to execute an I.R.C. § 6213(d) waiver with respect to which an assessment can be made and which can be filed with the Tax Court as a partial stipulation of settlement, leaving open [REDACTED] until a determination, litigation or settlement is made on the carryback issues.

If you have any questions with respect to this advice please call Joseph T. Chalhoub at FTS 566-3345.

MARLENE GROSS
Assistant Chief Counsel
(Tax Litigation)

By: 
HENRY G. SALAMY
Chief, Branch No. 4
Tax Litigation Division

Attachments:

Memo to CC:I 12/13/83
O.M. 19801 4/13/84
Memo to D.C. Hartford 10/21/81